

**NONPROFIT RESEARCH CORPORATIONS AND EDUCATION  
FOUNDATIONS AFFILIATED WITH VETERANS HEALTH  
ADMINISTRATION FACILITIES**

**TESTIMONY OF  
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**HOUSE COMMITTEE ON VETERANS' AFFAIRS  
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS**

**May 16, 2002**

Mr. Chairman and Members of the committee, I am here today to report on the Office of Inspector General's (OIG) work related to nonprofit research corporations and education foundations affiliated with Veterans Health Administration (VHA) facilities.

In 1988, Congress passed legislation granting VHA the authority to establish nonprofit corporations (NPC).<sup>1</sup> Prior to 1988, non-appropriated funds for VHA-approved research were generally administered through the VA Medical Center's General Post Fund (GPF) account or by an affiliated medical school. Congress expanded the authority of NPCs to include education in addition to research in 1999.<sup>2</sup>

During the period 1994-1997, we published three reports<sup>3,4,5</sup> that identified a need to improve accountability and oversight related to the administration of funds by VHA nonprofit research corporations.

A fiscal year 1994 OIG audit reported that a research and education foundation's board of directors and officers had not established sufficient written policies and procedures to ensure the stewardship of their corporation's activities, and had not developed an effective internal control structure. In addition, several of the largest corporate accounts were not designated for a specific research project and funds were used at the discretion of the researcher controlling the account. Also, we found that VHA had not provided adequate guidance regarding the types of expenditures research corporations could make

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<sup>1</sup> Veterans' Benefits and Services Act of 1988 (P.L. 100-322), May 20, 1988.

<sup>2</sup> Veterans Millennium Health Care and Benefits Act (P.L. 106-117), November 30, 1999.

<sup>3</sup> Audit of Atlanta Research and Education Foundation, Report No.: 4R3-A09-081, dated June 14, 1994.

<sup>4</sup> Review of VA Nonprofit Research Corporations, Report No.: 4R2-A09-078, dated June 14, 1994.

<sup>5</sup> Review of Nonprofit Corporations Established in the Veterans Health Administration, Report No.: 7R3-A19-064, dated March 20, 1997.

to facilitate VA research. We concluded the corporation did not maintain complete and accurate financial management and accounting records.

We recommended and VHA agreed that the research corporation establish an effective system of internal controls, develop policies and procedures to ensure expenditures facilitate VA research or related administrative overhead, and that VHA recover medical care appropriation resources inappropriately used to support AREF research.

In another fiscal year 1994 OIG report, we reviewed about \$1 million of \$3.6 million of expenditures spent at 3 research corporations and identified about \$625,000 spent on activities not directly related to research. We found that the research corporation spent funds for salaries of medical residents and on staff travel not clearly related to research or administration. We reported that the 3 research corporations spent funds for non-research related conferences, honoraria, gifts, awards, entertainment, and other non-research expenditures. In response, VHA agreed to publish national policy for the operation of research corporations that included guidance for administration, accounting, budgeting, and oversight. VHA published a new policy chapter governing nonprofit research corporations on May 20, 1994.<sup>6</sup> In our view, VHA's policy did not adequately address expenditure controls and did not provide adequate guidance over appropriate use of research funds. Subsequently, in November 2001, VHA published VHA Directive 1200 and VHA Handbook 1200.17 to provide further guidance for governing NPCs.<sup>7</sup>

In 1997, we issued a report in which we disclosed that a VA Medical Center (VAMC) provided radiology and laboratory services to an affiliated medical school, but the research corporation, not the VAMC, billed and received payment from the school for the services. As a result of poor record keeping, accountability to ensure Federal funds were used as Congress intended was lost.

Since fiscal year 1993, we have issued four other reports that address issues related to VHA's administration of research. Although these reports<sup>8,9,10,11</sup> do not directly address funds administered by the research corporations, the issues reported were related to VHA's administration of the research program and control over research funds. In these reports we made recommendations to strengthen controls over the use of research funds, personnel issues, and medical care fund reimbursements.

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<sup>6</sup> M-3, Part I, *Research and Development in Medicine - General*, subsequently rescinded by VHA Directive 1200 in November 2001.

<sup>7</sup> VHA published VHA Directive 1200 in November 2001 and VHA Handbook 1200.17 in December 2001.

<sup>8</sup> Audit of Allegations Concerning Research Administration VA Medical Center West Los Angeles, California, Report No.: 3R7-A99-044, dated January 25, 1993.

<sup>9</sup> Audit of Research and Travel Activities at VA Medical Center North Chicago, Illinois, Report No.: 4R4-A09-099, dated June 30, 1994.

<sup>10</sup> Audit of Allegations Concerning a Research Physician at Edward Hines, Jr. Veterans Hospital Hines, IL, Report No.: 8R4-A01-032, dated October 27, 1997.

<sup>11</sup> Evaluation of Financial and Administrative Controls in the Research Program at the VA Greater Los Angeles Healthcare System, Report No.: 99-00191-2, dated October 12, 2000.

In fiscal year 1993, we found that a private nonprofit research corporation operated at a VAMC without proper approval, written agreements, or management oversight. As a result, medical center's management oversight over funds, personnel, supplies, drugs, and animals used in the corporation's operations was limited or non-existent. We recommended establishing controls to account for the corporation's costs, ensuring VA costs were reimbursed, and the need for the corporation to obtain independent financial statement audits of the VA affiliated research and education corporation.

In a fiscal year 1994 OIG report on research administration, we reported that administrative activities in Research and Development (R&D) Service needed improvement, and medical center Fiscal Service staff needed to take action regarding one researcher's travel. We recommended that the R&D service terminate a researcher's activities, that the R&D service use appropriate procedures to control the financial relationship between the researcher and fund donors, and use appropriate budget control mechanisms to administer funds donated for specific research activities.

Also a fiscal year 1997 report identified a lack of sufficient control over research funds and the activities of principle research investigators. We also found that VA's medical care appropriation had not been reimbursed for resources expended in support of research projects run by the investigators. We recommended that the Network Director eliminate the opportunity for principle investigators to control research funds, establish a "proposed use of funds" for every research donation, and ensure that conflicts of interest were avoided.

In fiscal year 2000, at the request of a former VA Under Secretary for Health, we performed an evaluation of financial and administrative controls in a VAMC's Research Program. The Under Secretary requested a review because VHA managers found numerous deficiencies in the Research Service's financial and administrative operations. Because of the seriousness of these deficiencies, VHA management requested that the OIG evaluate research operations, with the objective of providing independent assurance that all the major financial and administrative deficiencies had been identified and effectively corrected by the VAMC's management. We concluded that the major deficiencies in financial and administrative operations had been identified and effectively corrected, but continued management oversight was needed to ensure that problems do not recur.

In each of the aforementioned reports, VHA agreed with our recommendations and proposed acceptable implementation plans.

In response to your letters dated March 22, and March 25, 2002, in which you present a series of questions regarding the monitoring and accountability requirements for VA's NPCs, we obtained responses to the questions that you asked from the Acting VA Under Secretary for Health; the Executive Director, National Association of Veterans' Research and Education Foundations (NAVREF); and the Chairman, Office of General Counsel's (OGC) Corporations Panel.

The Acting Under Secretary for Health but deferred questions related to potential conflict of interest and advocacy issues between NPCs, the VA OGC and NAVREF. We forwarded the questions concerning conflict of interest and advocacy issues to those organizations. VHA's responses and responses received from the NAVREF organization and the OGC's Corporations Panel; are compiled in Exhibit 1.

At the Committee's request, my staff has reviewed certain aspects of VA research corporations and the responses provided by the Department. We have focused on determining whether the required reports were submitted to the Congress for FY 2000. Our work included verifying that each VA research corporation required to obtain an independent financial audit and report corporate information to the Internal Revenue Service (IRS) were in compliance, and reported timely information.

Under current law, VHA is required to provide an annual report to Congress identifying the research corporations, and contributions they receive each year. Title 38, United States Code, Section 7366 delineates the accountability and oversight requirements over these corporations. Research corporations with revenues in excess of \$300,000 for any fiscal year shall obtain an independent audit of the corporation for that year. A research corporation with revenues between \$10,000 and \$300,000 shall obtain an independent financial audit of the corporation at least once every 3 years. The NPC shall include the most recent audit report in addition to the financial data in the corporation's report to the VA Secretary.

Our review showed that for FY 2000, the most recent reporting period, 88 VA research corporations reported total revenues of about \$174 million.<sup>12</sup> Of these 88 research corporations, 85 reported receiving contributions. Sixty-one of the 88 corporations were required to obtain an independent certified financial statement audit based on reporting total revenues in excess of \$300,000. We verified that all 61 NPCs complied with the requirement to obtain an independent audit, however one audit was not submitted in a timely manner. All 61 NPCs received independent audit opinions concluding that their financial statements present fairly, in all material respects, the financial position of the nonprofit corporations.

To determine whether the information reported to Congress was complete and consistent with the IRS information, my staff analyzed the Report of Independent Accountants, the NPC's Financial Statements, and the NPC's filed IRS Form 990 - *Return of Organization Exempt from Income Taxes* for the 30 of the largest revenue producing NPCs for the most recent reporting period. The IRS Form 990 is the primary source of data the Department uses to compile the Annual Report to Congress.

For one of the 30 largest research corporations, the independent auditors' reported non-compliance with U.S. Office of Management and Budget (OMB) Circular A-133 guidance and weaknesses in internal controls. That auditor reported two issues related to non-compliance. First, the auditor could not substantiate the methodology used to arrive

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<sup>12</sup> Per VHA policies and procedures, corporate reports for the prior FY are due to VHA by June 1<sup>st</sup> of every year.

at the indirect cost rate charged to Federal programs. Secondly, the research corporation was not filing the required quarterly Federal Cash Transaction Report. In addition, the auditor also disclosed seven issues related to internal controls.<sup>13</sup>

We verified that all 15 of the 88 NPCs reporting \$300,000 or more in Federal awards in FY 2000 complied with applicable OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* requirements. Financial audits were submitted to VA by the research corporations consistent with the provisions set forth in, OMB Circular A-133. OMB requirements refer to the Single Audit Act and are intended to promote sound financial management, including effective internal controls over Federal awards. These audits add an additional level of accountability and oversight over Federal funds to help ensure entities are maintaining internal controls over Federal programs and complying with laws, regulations, and the provisions of contract and grant agreements. The audits do not determine if funds are used as Congress intended, or that research projects are adequately meeting VA associated strategic goals and objectives.

In reference to your questions regarding the amount of administrative overhead expenditures spent administering VA research corporations, the Under Secretary for Health responded that the percentage spent in each research corporation for administrative overhead expenditures in FY 2001 averaged 10 percent of total expenditures, citing IRS Form 990 - *Return of Organization Exempt from Income Taxes* as the source of this data.

We found that 7 of the 15 NPCs required to comply with OMB Circular A-133 requirements, also have Indirect Cost Rate Agreements established with the Department of Health and Human Service (HHS), as the cognizant Federal agency responsible for the negotiation and approval of indirect cost rates. We were advised that two additional research corporations were in the process of negotiating their indirect cost rate agreements with HHS. The review process that cognizant Federal agencies follow to negotiate and approve indirect cost rate agreements represents another level of oversight and monitoring over non-profit organizations receiving Federal awards and such reviews generally include an assessment to determine whether NPCs have procedures for determining the allowability of costs to Federal awards according to the applicable cost principles and other terms of awards.

We found that 18 of the 88 NPCs reported total annual revenues of more than \$3 million in fiscal year 2000, but most reported less than \$2 million in annual revenues. Accordingly, we believe there may be an opportunity to redirect more funds to direct support of research by consolidating and reducing the number of corporations. Savings would come from avoiding administrative and overhead expenditures associated with

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<sup>13</sup> The seven issues are: 1) Absence of appropriate reviews -- Almost all accounts were unreconciled, cost center reports did not match claim forms, and transactions were not being recorded. 2) Accounting principles not applied appropriately. (No monthly closing or reconciliation, lease obligations improperly classified). 3) Expenditures not properly approved. 4) Internal controls intentionally (improperly) overridden. (Missing purchase orders, lack of approvals.) 5) Accounts lacked support documentation. 6) Lack of billing tracking or system. 7) Failure to safeguard physical assets from loss, misappropriation, or damage.

maintaining 88 individual financial management and payroll systems, obtaining annual audits, meeting Internal Revenue Service reporting requirements, and other administrative costs.

We found no evidence to lead us to believe that the information VA reported to Congress was not complete and reliable. However, we believe that annual reporting could be enhanced to give Congress improved visibility over the use of funds to ensure that research funds are used as intended. The annual report to Congress could provide detailed expenditure reporting to facilitate oversight by VHA. We also believe an opportunity exists to help ensure that funds are used as intended by Congress, by improving the visibility over research corporation operations.

Our observations are brought to your attention to supplement the information provided by VA in response to the series of questions by your Committee. This concludes my testimony. I would be pleased to answer any questions that you and the Members of the committee may have.

